

Message Text

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ACTION EUR-08

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P 281912Z MAY 75

FM AMEMBASSY LONDON

TO SECSTATE WASHDC PRIORITY 1481

C O N F I D E N T I A L SECTION 01 OF 02 LONDON 08066

LIMDIS

PASS TREASURY FOR: ASST. SECY. HICKMAN; DEPUTY ASST. SECY.
WIDMAN; MESSRS. R. PATRICK, N. GORDON

E.O. 11652: XGDS-1

TAGS: EFIN, UK

SUBJECT: US/UK DOUBLE TAXATION NEGOTIATIONS

1. POLITICAL COUNSELLOR ACCOMPANIED BY FINANCIAL ATTACHE WERE CALLED TO FOREIGN OFFICE BY DEREK THOMAS, HEAD OF NORTH AMERICAN DESK, TO DISCUSS STATE OF US/UK DOUBLE TAXATION NEGOTIATIONS. THOMAS EXPLAINED THAT THE FOREIGN OFFICE WAS NOT CONCERNED WITH THE TECHNICAL ISSUES INVOLVED, BUT RATHER WAS BROUGHT INTO THE PICTURE LAST WEEK WHEN THE BOARD OF INLAND REVENUE CONSULTED CHANCELLOR HEALEY ON THE LINE TO BE TAKEN THIS WEEK IN THE WASHINGTON NEGOTIATIONS. CHANCELLOR GAVE INSTRUCTIONS THAT FOREIGN OFFICE SHOULD BE CONSULTED.

2. PARTICULAR POINT GIVING THE UK GREATEST DIFFICULTY IS THE SUGGESTION THAT IT MAY BE NECESSARY TO TERMINATE THE DIVIDEND ARTICLE IN THE EARLIER TREATY AS OF JANUARY 1, 1976, GIVING NOTICE PRIOR TO JUNE 30, 1975. THOMAS SAID HIS SUPERIOR, SIR DONALD MAITLAND, WOULD NORMALLY HAVE CONSULTED FOREIGN MINISTER CALLAGHAN ON THE ISSUE. IN CALLAGHAN'S ABSENCE, THE MINISTER AVAILABLE WAS THE PARLIAMENTARY UNDER SECRETARY OF STATE LORD GORONWY-ROB-
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ERTS. GORONWY-ROBERTS EXPRESSED "MINISTERIAL CONCERN"

AND HOPED VERY MUCH THAT BEFORE ANY ACTION OF SUCH KIND IS TAKEN, THE FOLLOWING POLITICAL IMPLICATIONS WILL BE CAREFULLY WEIGHED:

A. FRANCE HAS AN IMPUTATION TAX SYSTEM AND THE U.S. HAS A DOUBLE TAXATION AGREEMENT WITH THE FRENCH. SHOULD THE UK ACCEPT THE US PROPOSALS, IT WOULD BE SETTling ON TERMS WORSE THAN THE FRENCH RECEIVED; THERE COULD BE "GREAT POLITICAL DIFFICULTIES" WITH PARLIAMENT IF THE OUTCOME IS LESS SATISFACTORY THAN THAT RECEIVED BY THE FRENCH. WHILE THE UK IS NOT TRYING TO HIDE BEHIND THE FRENCH. IT DOES NOT UNDERSTAND WHY IT SHOULD BE ASKED TO AGREE TO SOMETHING LESS FAVORABLE

B. IF THE DIVIDEND ARTICLE WERE TERMINATED, THERE WOULD BE A CRITICAL REACTION AS A RESULT OF THE NEGATIVE IMPACT ON THE UK BALANCE OF PAYMENTS. RAISING THE US WITHHOLDING RATE FROM 15 TO 30 PERCENT COULD COST THE UK 15 MILLION POUNDS IN FOREIGN EXCHANGE.

C. IF THE UK ACCEPTED THE US PROPOSALS, IT WOULD THEN HAVE TO MEET DEMANDS FROM OTHER COUNTRIES FOR SIMILAR TREATMENT. IN AN EC CONTEXT, THIS COULD CREATE A DIFFICULT SITUATION.

3. THOMAS SAID UK RECOGNIZES THAT THE TALKS HAVE DRAGGED ON FOR A LONG TIME, BUT IT IS NOT ENTIRELY THE UK'S FAULT. THE FOREIGN OFFICE FINDS IT DIFFICULT TO BELIEVE SUCH AN UNSATISFACTORY OUTCOME COULD BE CONTEMPLATED.

4. IN REPLY, THE EMBASSY OFFICERS POINTED OUT THE DISCRIMINATION IN TAX TREATMENT BETWEEN A US DIRECT INVESTOR AND A UK INVESTOR IN THE UK, THE US DIRECT INVESTOR PAYING A 52 PERCENT RATE OR EVEN 70 TO 76 PERCENT RATE IF DIVIDENDS ARE PAID FROM ACCUMULATED EARNINGS, WHEREAS THE UK INVESTOR, DEPENDING ON THE PERCENTAGE OF DISTRIBUTION, COULD PAY ANYWHERE FROM 28 TO 52 PERCENT. THOMAS ACKNOWLEDGED THAT US DIRECT INVESTORS HAVE NOT BEEN BENEFITTING FROM THE DIVIDEND CLAUSE IN THE TREATY SINCE 1972, WHEN THE IMPUTATION TAX SYSTEM WAS INTRODUCED.

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5. AS OTHER ELEMENTS IN THE US PROPOSALS TO THE UK WERE SPELLED OUT (BASED ON HICKMAN PRESENTATION IN APRIL) EMBASSY OFFICERS STRESSED THE GENEROSITY OF THE ENTIRE US OFFER, WHICH WOULD STILL LEAVE DISCRIMINATION AGAINST US COMPANIES VIS-A-VIS UK DOMESTIC INVESTORS. FINANCIAL ATTACHE POINTED OUT THE BENEFITS TO THE UK FROM THE US PROPOSALS THAT WOULD ELIMINATE WITHHOLDING ON DIVIDENDS TO UK RESIDENTS, WHICH WOULD STILL LEAVE THE EFFECTIVE UK

TAX RATE FOR A US INVESTOR ABOVE THE COMPARABLE RATE FOR

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C O N F I D E N T I A L SECTION 02 OF 02 LONDON 08066

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UK INVESTORS, WHICH COULD RESULT IN A POTENTIAL LOSS TO THE US TREASURY BECAUSE OF EXCESS CREDIT, STRESSING WITH ALL OF THE ADDITIONAL BENEFIT GOING TO THE INVESTOR, NONE TO THE US TREASURY.

6. THE EMBASSY OFFICERS ACKNOWLEDGED THAT THERE WERE WIDER IMPLICATIONS. FINANCIAL ATTACHE STRESSED THE CONTINUING AND INCREASING CONCERN FROM THE AMERICAN BANKS ASSOCIATION IN LONDON AND THE US CHAMBER OF COMMERCE HERE. THEY HAVE BEEN VOCIFEROUS IN COMPLAINTS TO US TREASURY. AT SOME POINT, IT IS FAIR TO ASSUME THEY WILL ALSO COMPLAIN TO CONGRESS. THERE WILL BE A WORSENING INVESTMENT CLIMATE IN THE UK IF RELATIVE NEUTRALITY OF TREATMENT COULD NOT BE REIMPOSED. ON PERSONAL BASIS, ACKNOWLEDGING PERSONAL AMITY AND COURTEOUSNESS OF UK INLAND REVENUE NEGOTIATORS, FINANCIAL ATTACHE ALSO CITED THEIR OBDURATE POSITIONS BASED ON THEOLOGY AND NEED TO ARRIVE AT EC TAX HARMONIZATION IN THE DISTANT FUTURE WHICH UK NEGOTIATORS SAID PREVENTED THEM FROM MEETING THE US POINT OF VIEW, ALTHOUGH SOME CREDIT FOR ACT OF A LIMITED NATURE IS GIVEN TO UK CORPORATIONS. THE US IS INTERESTED IN PRACTICAL RESULTS THAT WILL FACILITATE TRADE AND INVESTMENT RATHER THAN IN THEOLOGY. STILL SPEAKING PERSONALLY, FINANCIAL

ATTACHE SAID HE BELIEVED ANY OBJECTIVE US NEGOTIATOR WOULD HAVE REACHED THE SAME POINT OF VIEW CONCERNING TERMINATION OF THE TREATY ARTICLE GIVEN APPARENT UNWILLINGNESS OF CONFIDENTIAL

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THE INLAND REVENUE TEAM TO MAKE MEANINGFUL CONCESSIONS IN THE NEGOTIATION. THERE SEEMED LITTLE POINT IN THE US CONTINUING WITH A TREATY CLAUSE THAT EFFECTIVELY GAVE BENEFITS TO ONLY ONE PARTNER IN THE TREATY AND WHICH ENABLED UK TO WITHHOLD THE BENEFITS FROM US DIRECT INVESTORS ON THE GROUNDS OF THEOLOGY. FOREIGN OFFICE POLICY CONSIDERATIONS MIGHT BETTER BE ADDRESSED TO THE UK INLAND REVENUE NEGOTIATING TEAM RATHER THAN THE US EMBASSY.

7. THOMAS SAID HE HAD NOT BEEN AWARE OF THE WIDE DISPARITY IN THE POSITION OF US AS OPPOSED TO UK INVESTORS NOR HAD HE BEEN AWARE OF US OFFER TO ELIMINATE WITHHOLDING NOR HAD HE BEEN AWARE OF INTENSE PRESSURE FROM THE US BUSINESS COMMUNITY. HE WOULD REPORT THESE VIEWS BACK TO HIS SUPERIORS, WITH A CABLE TO UK EMBASSY WASHINGTON BUT STILL HOPED SOME FORM OF ACCOMMODATION AND EXTENSION OF NEGOTIATIONS COULD TAKE PLACE. EMBASSY OFFICERS REPLIED THAT THEY ASSUMED THIS WOULD BE DEPENDENT UPON THE FLEXIBILITY OF THE UK NEGOTIATING TEAM AND UK'S DESIRE TO MAINTAIN A FAVORABLE INVESTMENT CLIMATE.

8. COMMENT: IF THOMAS'S ATTITUDE IS REFLECTED IN HIS REPORT TO HIS SUPERIORS, IT IS FAIR TO ASSUME THAT THE INLAND REVENUE TEAM WILL COME UNDER SOME INCREASED PRESSURE TO YIELD GROUND, BUT HOW MUCH IS UNCERTAIN GIVEN THOMAS'S EQUALLY OBVIOUS CONCERN ABOUT US-FRENCH TREATY AND EC CONSIDERATIONS. HOWEVER, NOTHING IN HIS PRESENTATION GAVE INDICATION THAT INLAND REVENUE POSITION HAS CHANGED FROM WHAT IT WAS IN APRIL. FOREIGN OFFICE CONCERN DOES OBVIOUSLY REFLECT VIEW OF LARGER CONSIDERATIONS. THROUGHOUT, EMBASSY OFFICERS STRESSED THAT IF UK IS UNWILLING TO NEGOTIATE A MUTUALLY BENEFICIAL TREATY OR DIVIDEND CLAUSE, IT SHOULD NOT EXPECT US TO CONTINUE WITH ONE WHICH IS PATENTLY BENEFICIAL TO ONLY ONE PARTY IN THE AGREEMENT. THOMAS TOOK THE POINT. IF AFTER MEETINGS IN WASHINGTON THIS WEEK, SHOULD US TREASURY DECIDE TO TERMINATE DIVIDEND ARTICLE, WE RECOMMEND TIMING OF ANNOUNCEMENT BE MADE AFTER UK'S JUNE 5 EC REFERENDUM.

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